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DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA MNUGENT
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BEXP, KIPR, KWMN, IN
SUBJECT: INDIAN ECONOMY SHOWING SIGNS OF RECOVERY

NEW DELHI 00000872 001.2 OF 003

¶1. (SBU) Summary: The Indian economy is showing some signs of recovery from the current slowdown, with many analysts predicting that the downward cycle is expected to bottom out in the second half of FY 2009-10 (October-April). The core sector (including power, cement, and steel) and automobiles, telecom, port traffic and retail sales are already showing signs of increased activity. The rural demand for goods and services appears quite robust and the outlook of the agricultural sector looks optimistic, as "near" normal monsoons are predicted. Hiring in sectors such as banking is also showing some signs of increase. However, it is too early to conclude that this is the start of a next broad-based expansion. Many industries such as manufacturing, small and medium enterprises, real estate, tax collections and exports remain in the red. India's structurally broad industrial base suggests that industrial growth will need more time to get back to normal. Although the IMF recently downgraded India's growth projection to 4.5% in calendar year (CY) 2009, these recent signs of recovery suggest the possibility of above-5 percent growth. Even with the IMF's lower estimate, it still pegs as one of the fastest growing economies in the world, after China. End Summary.

Some Sectors Showing Glimmers of Hope

¶2. (SBU) Planning Commission Deputy Chairman and de facto Finance Minister Montek Singh Ahluwalia has said that the stimulus packages and duty cuts announced by the government to revive the economy in the past five months have started paying dividends, as evidenced by growth in key sectors noted below. He expects the economy to start showing definite signs of recovery in the second half of the FY 2009-10, that is, from October onwards. This week, Swiss Bank, UBS AG, Barclays, Capital and Marquarie Bank also observed that the Indian economy seems to be improving, and that the slump in emerging Asia is over. Economists also point out that revival might be around the corner, driven by interest rate cuts by the Reserve Bank of India, a recovery in the Chinese economy, and a strong growth in the outsourcing sector. The following positive trends also suggest a turnaround is more probable than not later this year:

--The capital goods sector showed a healthy growth of 10.4 percent in February compared to February 2008. The core sector, consisting of output of steel, cement, electricity, coal, and oil products,

which together comprise 26.7 percent of the index of industrial production (IIP), is also back on the track. It grew by 2.9 percent in March, the highest year-on-year growth since September 2008. The biggest surprise was power generation which touched a 13-month high at 5.9 percent in March. The availability of coal has improved and the coal units that were commissioned last year are working well, resulting in higher generation of power, according to news reports.

--Cement output registered buoyant growth of 10.1 percent in March, showing healthy construction levels. Dispatches were also robust in March, due to restocking, and strong rural demand. Mutual funds have increased their exposure in leading cement firms, suggesting they expect sustained demand. The 212 million ton-cement industry may add around 30 million tons of new capacities this fiscal year.

--Steel output, which had declined from September through November last year, showed some recovery in December and January this year. However, it declined by 2.6 percent in March. According to the World Steel Association, India is the only economy whose steel consumption is expected to grow by more than 5 percent in 2009 due to high spending on various construction and infrastructure projects. The construction industry, which has a multiplier effect, is responding to higher government expenditures and lowering of interest rates for private borrowers.

--The auto industry recovered in March 2009, with total automobile production exceeding total sales for the first time in seven months. Cars and two-wheelers growth was aided by the four percent cut in central excise tax from the December stimulus package and from discounts. The increase in government salaries, coupled with the better credit availability and the launch of new models (including Tata's Nano), could result in sustained trends in the coming months.

NEW DELHI 00000872 002.2 OF 003

-- Many retailers have continued their expansion plans in the past 12 months and are banking on latent rural demand and aggressive promotional discounts to boost growth.

--India continues to be the fastest-growing telecom market in the world, adding 15.64 million wireless subscribers in March, and taking the total number of subscribers to 391.76 million. Declining tariffs and innovative services have resulted in wireless technologies becoming the preferred mode of communication in rural markets.

--Port traffic at 12 major ports seems to have improved modestly in March. It remained negative at 7 out of 12 ports in March 2009, versus 9 ports in February 2009. Though trends in air passenger traffic remain weakened in 2009, the low fares and some reduced surcharges could result in positive growth in traffic in FY 2009-10.

--New gas facilities became operational in April. Taking into account lower oil prices and new hydrocarbon discoveries by Reliance, Cairn, and the state-owned Oil and Natural Gas Corporation, Citi projects that India's net oil imports this fiscal year could be \$30 billion lower than last fiscal year.

--Foreign Institutional Investors (FIIs) turned net 2009 buyers in the Indian markets in April, after being net sellers in January to March of \$1.3 billion. FIIs sold \$13 billion worth of equities in 2008. The Sensex was the top performer among leading global indices in April 2009 with returns of 17.7 percent in dollar terms.

More Jobs Coming Up

13. (SBU) Oscar Fernandes, Labor Minister, recently indicated that half a million jobs had been lost in India due to the slowdown. However, media is reporting in recent weeks that firms started hiring again in April 2009. Headhunters have seen a 50 percent rise in the number of queries issued by companies in the past weeks, led mainly by health and pharmaceutical sectors. Other sectors driving

up the hiring exercise include life sciences, infrastructure and manufacturing. Public sector banks plan to hire 30,000 employees in 2009-10, due to new opportunities in the banking sector owing to branch expansion. A recent survey by Hewitt says that 60 percent of Indian companies are still hiring. Corporate employees expect their salaries to increase by 8 percent this year.

...But Things Still Not Back to Normal

¶4. (SBU) While positive data are trickling in, it is too soon to call it a "recovery". A number of indicators are a cause of concern. Manufacturing declined by 1.4 percent in February. With exports also estimated to have declined by 30 percent in March, industrial growth may remain weak in the coming months and may only recover gradually. However, the fall in India's industrial production has been less when compared to other Asian economies primarily because India is not heavily dependent on exports.

¶5. (SBU) Falling real estate prices, coupled with low transaction volumes are also a cause of worry. Despite lower property prices, growth in outstanding housing loans, used as a proxy for residential transaction volumes/demand remains weak. House buyers, though in small numbers, have started returning to the market after developers cut property prices between 25-40 per cent for new bookings. But a majority of the buyers are said to be still waiting for a further correction in prices.

Comment

¶6. (SBU) The recent monthly numbers are not sufficient to conclude that the economy has fully turned the corner and is recovering. Individually, none of the indicators are hugely powerful, but

NEW DELHI 00000872 003.2 OF 003

collectively they should drive a recovery later this year which is likely to gain momentum in 2010. They also demonstrate the strength of the domestic market, including a lot of healthy purchasing power in the rural sector. Exports, a main channel of manufactured products, will have to wait for economic revival in the US and Europe. However, other areas of industrial growth, along with sustained demand for services, and some good agricultural output, can maintain a healthy level of economic growth and employment, that suggest India will experience a V-shaped recovery in the latter half of the year.

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